
LOUISIANA INSURANCE GUARANTY ASSOCIATION

FINANCIAL STATEMENTS
(Cash Basis)

DECEMBER 31, 2012 AND 2011



A Professional Accounting Corporation

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LOUISIANA INSURANCE GUARANTY ASSOCIATION

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Independent Auditors' Report

Members and Directors
Louisiana Insurance Guaranty Association
Baton Rouge, Louisiana

We have audited the accompanying financial statements of Louisiana Insurance Guaranty Association (the Association), which comprise the statements of assets and liabilities arising from cash transactions as of December 31, 2012 and 2011, and the related statements of activities arising from cash transactions for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis of accounting described in Note 1. This includes determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities arising from cash transactions of Louisiana Insurance Guaranty Association, as of December 31, 2012, and 2011, and its activities arising from cash transactions during the years then ended in accordance with the cash basis of accounting described in Note 1.

Emphasis of Matter - Basis of Accounting

We draw attention to Note 1 of the financial statements, which describes the Association's basis of accounting. The financial statements are prepared on the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Postlithwaite & Nutterville

Baton Rouge, Louisiana

March 1, 2013

LOUISIANA INSURANCE GUARANTY ASSOCIATION
BATON ROUGE, LOUISIANA

STATEMENTS OF FINANCIAL POSITION
ARISING FROM CASH TRANSACTIONS
DECEMBER 31, 2012 AND 2011

ASSETS

	<u>2012</u>	<u>2011</u>
Cash	\$ -	\$ 84,922
Investments, at cost	<u>234,425,929</u>	<u>232,875,922</u>
	<u>\$ 234,425,929</u>	<u>\$ 232,960,844</u>

LIABILITIES AND NET ASSETS

Outstanding checks in excess of bank balances	\$ 302,505	\$ -
Net assets - restricted	<u>234,123,424</u>	<u>232,960,844</u>
	<u>\$ 234,425,929</u>	<u>\$ 232,960,844</u>

The accompanying notes are an integral part of these statements.

LOUISIANA INSURANCE GUARANTY ASSOCIATION
BATON ROUGE, LOUISIANA

STATEMENTS OF ACTIVITIES
ARISING FROM CASH TRANSACTIONS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
<u>RECEIPTS</u>		
Distributions from liquidators	\$ 4,207,400	\$ 16,892,024
Interest income	7,633,251	8,059,162
Net loss on disposition of investments	(2,254,005)	(908,644)
Restitution	144,005	16,644
Assessments	398,979	-
	<u>10,129,630</u>	<u>24,059,186</u>
<u>DISBURSEMENTS</u>		
Claims paid	6,105,404	4,009,471
Legal fees and expenses	1,381,994	1,396,694
Claims handling costs	411,533	261,524
Professional and bank fees	64,275	110,331
Staff salaries, taxes, and benefits	687,104	662,076
Travel, meetings, and seminars	16,555	17,615
Building expenses	14,066	12,932
Administrative expenses	286,119	276,625
	<u>8,967,050</u>	<u>6,747,268</u>
<u>EXCESS OF RECEIPTS OVER DISBURSEMENTS</u>	1,162,580	17,311,918
Net assets - beginning of the year	<u>232,960,844</u>	<u>215,648,926</u>
Net assets - end of the year	<u>\$ 234,123,424</u>	<u>\$ 232,960,844</u>

The accompanying notes are an integral part of these statements.

LOUISIANA INSURANCE GUARANTY ASSOCIATION
BATON ROUGE, LOUISIANA

NOTES TO FINANCIAL STATEMENTS

1. Significant Accounting Policies

Organization

The Louisiana Insurance Guaranty Association (the Association) is an organization created by the Louisiana Insurance Guaranty Act to pay for the claims against insolvent member insurance companies. Funds are provided for the payment of the claims by the assessment of the remaining member insurance companies. All admitted insurance companies doing business in Louisiana are required to be members of the Association (excluding the following lines of business: life, health and accident, title, disability, mortgage guaranty, and ocean marine insurance, as well as all types of reinsurance).

The Association's day-to-day operations and management are performed by the Association's staff under the direction of the Board of Directors. The Association may also contract with outside staffing services, claims service providers, and other professionals to carry out these functions.

Accounting Method

The Association's policy is to prepare its financial statements on the basis of cash receipts and disbursements; consequently, revenue and related assets are recognized when received, and expenses and related liabilities are recognized when paid. Accordingly, no liabilities are recorded for future payments for return of unearned premiums, loss claims and related expenses, or return of early access distributions received. As discussed in Note 6, the Association regularly estimates amounts for such liabilities.

Equipment and Facilities

The Association recognizes equipment and facilities as cash disbursements when incurred. These items are not capitalized and depreciated under the Association's cash basis of accounting.

Income Taxes

The Association is exempt from income taxes under Internal Revenue Code Section 501(c)(6); therefore, no provision for income taxes has been made.

The Association recognizes the effect of uncertain income tax positions only if the positions are more likely than not of being sustained. Recognized income tax positions are recorded at the largest amount that is greater than 50% likely of being realized. Changes in the recognition or measurement are reflected in the period in which the change in judgment occurs. The Association has evaluated its position regarding the accounting for uncertain income tax positions and does not believe that it has any material uncertain tax positions. With few exceptions, the Association is no longer subject to federal, state, or local tax examinations by tax authorities for years before December 31, 2009.

LOUISIANA INSURANCE GUARANTY ASSOCIATION
BATON ROUGE, LOUISIANA

NOTES TO FINANCIAL STATEMENTS

2. Restricted Net Assets

Net assets represent funds collected from member insurance companies, distributions from liquidators, interest income, and other receipts in excess of funds disbursed to pay claims and expenses of the Association. All assets are considered restricted under the Act which created the Association. Excess funds are to be used for the payment of claims, return of unearned premiums and reimbursement of expenses incurred for the insolvent member insurance companies (See Note 6) and return of early access distributions to liquidators (See Note 5). There were no returns of assessments authorized during 2012 or 2011.

3. Investments

The Association's investments are recorded at cost and consisted of the following at December 31, 2012 and 2011:

	<u>2012</u>		<u>2011</u>	
	<u>Cost</u>	<u>Estimated Fair Value</u>	<u>Cost</u>	<u>Estimated Fair Value</u>
Short-term repurchase agreements	\$ 1,125,989	\$ 1,125,989	\$ 464,495	\$ 464,495
Money market accounts invested in U.S. Treasury obligations	4,589,868	4,589,868	2,023,158	2,023,158
U.S. Treasury notes and bonds	180,248,312	179,019,492	178,044,649	179,812,857
U.S. Government Agency obligations	<u>48,461,760</u>	<u>48,236,390</u>	<u>52,343,620</u>	<u>51,970,202</u>
	<u>\$234,425,929</u>	<u>\$232,971,739</u>	<u>\$232,875,922</u>	<u>\$ 234,270,712</u>

The Association's policy is to purchase securities issued by the U.S. Treasury and obligations issued or guaranteed by the U.S. Government and its Agencies. The estimated fair value of these securities is based on quoted market prices. The Association enters into short-term repurchase agreements with financial institutions whereby the Association purchases U.S. Government securities with an agreement to resell the securities to the financial institution at cost. The Association also deposits funds in money market accounts invested in U.S. Treasury obligations.

The Association purchases securities at premiums or discounts from the contractual maturity amount of the security. Pursuant to the cash basis of accounting, these premiums and discounts are not amortized over the holding period of the security. Instead, investments are stated at original cost and any premiums or discounts are reported as gains or losses upon maturity or sale of the respective security. Accordingly, interest income represents the contractual interest payments received under the investment securities.

LOUISIANA INSURANCE GUARANTY ASSOCIATION
BATON ROUGE, LOUISIANA

NOTES TO FINANCIAL STATEMENTS

3. Investments (continued)

The cost and estimated fair value of investments at December 31, 2012, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less	\$ 51,856,155	\$ 50,262,340
Due after one year through five years	<u>182,569,774</u>	<u>182,709,399</u>
	<u>\$ 234,425,929</u>	<u>\$ 232,971,739</u>

4. Assessments

Louisiana Revised Statute 22:2058 gives the Association the authority to assess member insurance companies the amount necessary to pay the obligations and expenses of the Association. Beginning January 1, 2003, and thereafter, the assessment to member insurance companies is not to exceed an amount equal to one percent (1%) of net direct written premiums during the preceding calendar year, unless changed by the Louisiana Legislature. During 2012, the Association received \$398,979 of assessments from a member Company that was assessed in prior years.

5. Distributions from Liquidators

The Association files claims against the estates of insolvent insurers in an effort to recover a portion of the policyholders' claims paid and related expenses from the assets of the insolvent insurers. During the years ended December 31, 2012 and 2011, the Association received \$4,207,400 and \$16,999,361, respectively, of such distributions which are reflected as receipts in these financial statements. No estimate is available of future potential distributions from liquidations.

Distributions received from liquidators are included in the Association's net assets. However, distributions received from liquidators prior to the closing of the insolvent insurer estate may be subject to return of the distribution under provisions of the early access agreements with the estate. During the years ended December 31, 2012 and 2011, the Association returned \$0 and \$107,337, respectively of early access distributions which had previously been received from liquidators under the terms of those agreements. Management estimates that \$63 million of early access distributions have been collected which are subject to return to liquidators.

6. Estimate of Future Return of Unearned Premiums and Claims Payments (Not Audited)

The funds of the Association are used to pay insurance claims of insolvent member insurance companies (See Note 2). These claims are pursuant to the Louisiana Insurance Guaranty Law, La. R.S. 22:2051-2070. As of December 31, 2012, the Association had 1,309 open claims files outstanding, a substantial portion of which are involved in litigation. Additionally, other member insurance companies may be declared insolvent subsequent to the date of these financial statements.

LOUISIANA INSURANCE GUARANTY ASSOCIATION
BATON ROUGE, LOUISIANA

NOTES TO FINANCIAL STATEMENTS

6. Estimate of Future Return of Unearned Premiums and Claims Payments (Not Audited) (continued)

Due to the uncertainty involved in accepting and administering insolvent companies, as well as the difficulty in determining reliable estimates, the Association maintains its financial records on a cash basis. However, the Association regularly attempts to estimate the amount of claims and claims administration expenses related to insolvent member insurance companies. This case based reserve setting practice is a common function of managing and administering those losses.

Provided below is an unaudited condensed balance sheet of the Association at December 31, 2012, on a modified accrual basis which recognizes management's estimate of the undiscounted claims and related liabilities. This information is intended to reflect only certain estimated assets and liabilities of the Association and is not intended to represent the financial position of the Association in accordance with accounting principles generally accepted in the United States of America. These estimates are expected to vary as additional information becomes available.

The unaudited condensed balance sheet below does not provide for accruals of amounts which may be due from liquidators of insolvent insurance companies, early access distributions subject to refund, billed but uncollected member assessments due, capitalization and depreciation of property and equipment, adjustments of investments to estimated fair value, accruals for restitution recoveries, and accruals of operating costs owed at year end not included in the reserves for claims administration expenses.

As described in Note 4, the Association has been granted the authority to assess member insurers at a rate of one percent (1%) of net direct written premiums annually beginning January 1, 2003, which, if assessed, is estimated to produce approximately \$68 million annually. Additionally, La. R.S. 22:2058 provides that if the maximum assessment and other assets available to the Association are insufficient to make all necessary payments, the Association may borrow additional funds or payments can be reduced on a prorated basis and unpaid balances are to be paid as funds become available.

ASSETS

	December 31, 2012 <u>(Unaudited)</u>
Cash	\$ -
Investments, at cost	<u>234,425,929</u>
Total assets	<u>\$ 234,425,929</u>

LIABILITIES AND NET DEFICIT

Outstanding checks in excess of bank balances	\$ 302,505	
Estimated claims and claims administration expenses payable	<u>241,500,000</u>	(1)
Total liabilities	241,802,505	
Net deficit	<u>(7,376,576)</u>	(2)
Total liabilities and net deficit	<u>\$ 234,425,929</u>	

LOUISIANA INSURANCE GUARANTY ASSOCIATION
BATON ROUGE, LOUISIANA

NOTES TO FINANCIAL STATEMENTS

6. Estimate of Future Return of Unearned Premiums and Claims Payments (Not Audited) (continued)

- (1) Represents management's estimate of claims and claims administration expense reserves related to open claim files at December 31, 2012.

The Association has been notified of claims, as well as threatened claims, by certain large insureds of insolvent insurance companies relating to the use and production of asbestos, silica, tobacco, and environmentally hazardous materials. The Association continues to evaluate the merits of these claims, the appropriateness of coverage under the Act, and the amount of potential liability to the Association.

Management includes in the reserve for claims and claims administration expense amounts estimated as the Association's liability for these claims based on present statutes and based on the best information available at this time. However, there are numerous and significant uncertainties regarding the amount of ultimate liability the Association may be responsible for under these claims and when amounts ultimately determined as owed by the Association become due and payable. As facts and circumstances develop, management intends to revise its estimates of these claims liabilities. Revisions in these estimates could result in significant increases or decreases in these estimates.

- (2) Due to the uncertainty of the timing and amount of claims to be paid by the Association, it is unknown whether the Association can meet all of its claims obligations as they become due. Additionally, as described in Note 5, the Association has received early access distributions of approximately \$63 million from the estates of insolvent insurers which remain subject to claw back provisions by the respective estate if those funds are requested. Any demands for return of early access distributions would also increase the above deficit.

The Association has the statutory authority to assess up to 1% of member insurers' net direct written premiums annually if necessary to pay its obligations as described in Note 4. The Association's financial resources also include receipt of investment earnings and the continued receipt of proceeds from liquidators of insolvent insurance companies.

7. Subsequent Events

Management has evaluated subsequent events through the date that the financial statements were available to be issued, March 1, 2013, and determined that there were no events that required additional disclosure. No subsequent events occurring after this date have been evaluated for inclusion in these financial statements.

**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements Performed
in Accordance with Government Auditing Standards**

Members and Directors
Louisiana Insurance Guaranty Association
Baton Rouge, Louisiana

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the cash-basis financial statements of Louisiana Insurance Guaranty Association (the Association) as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Association's financial statements, and have issued our report thereon dated March 1, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Association's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of the deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Louisiana Insurance Guaranty Association's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Postlethwaite & Nutterville

Baton Rouge, Louisiana
March 1, 2013